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No. 1087

In the Supreme Court of the United States

OCTOBER TERM, 1969

LIKINS-FOSTER HONOLULU CORP., ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 1037

LIKINS-FOSTER HONOLULU CORP., ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinions of the Tax Court (Pet. Apps. B and C) are not officially reported. The opinion of the court of appeals (Pet. App. A) is reported at 417 F. 2d 285.

JURISDICTION

The judgment of the court of appeals was entered on November 16, 1969 (Pet. 2). The petition for a writ of certiorari was filed on January 5, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the courts below correctly held that gains realized by certain of the petitioner corporations (the "Wherry" corporations) from the condemnation sales of their mortgaged properties to the United States did not qualify for nonrecognition under Section 337 of the Internal Revenue Code of 1954, because the sales occurred when title and possession passed to the United States, which was prior to the Wherry corporations' adoption of plans of liquidation.

2. Whether the Commissioner abused his discretion under Section 482 of the Internal Revenue Code of 1954 in allocating gain realized on the sale of houses from the corporations which purportedly sold the houses and reported the gain, to a commonly controlled corporation which had constructed the houses, where all of the corporations were part of a consolidated group and the construction corporation transferred the properties to the selling corporations solely for the purpose of providing the latter with current income to be offset against operating loss carryovers which could not otherwise be used.

STATUTES AND REGULATIONS INVOLVED

Pertinent statutory provisions are set forth in Appendix D to the petition. Additional statutory provisions and pertinent Treasury Regulations on Income Tax (1954 Code) are set forth in the Appendix, *infra,* pp. 17–21.

STATEMENT

Petitioners are a parent corporation, Likins-Foster Honolulu Corporation ("Honolulu"), various of its wholly or partially owned subsidiaries, and the shareholders of these corporations.[1] The corporations directly affected by the questions presented by this petition are four Wherry corporation subsidiaries,[2] and another subsidiary, Likins-Foster Topeka Corporation ("Topeka").[3] The tax years in issue are fiscal years ended June 30, 1957, 1958, and 1959. During those fiscal years and until February 10, 1958, these corporations were members of a consolidated group for tax purposes. After that date, the four Wherry corporations ceased to be members of the consolidated group. (Pet. App. B 18.)

I

The Wherry Act housing projects of the four Wherry corporations were condemned by the United States on October 30 and November 1, 1957, pursuant

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[1] The relationships between the parties were set out in detail by the Tax Court (Pet. App. B 25–28).

[2] They are: Likins-Foster Ord Corporation ("Ord"); Likins-Foster Monterey Corporation ("Monterey"); Likins-Foster Biggs Corporation ("Biggs"); Likins-Foster El Paso Corporation ("El Paso"). Each Wherry corporation entered into a contract with the Secretary of the Army pursuant to the so-called Wherry Act (Act of August 8, 1949, c. 403, 63 Stat. 570, Sec. 1 (12 U.S.C. 1748 *et seq.*)), whereby it leased land and constructed housing for rent to military personnel (Ord and Monterey in California; Biggs and El Paso in Texas). (Pet. App. B 46.)

[3] Topeka constructed and owned 421 houses and duplexes in Topeka, Kansas, which it rented to personnel at Forbes Air Force Base (Pet. App. B 28–29).

to the provisions of the so-called Capehart Housing Act (Housing Amendments of 1955, c. 783, 69 Stat. 635, Sec. 404 (b) as amended by Sec. 512, Housing Act of 1956, c. 1029, 70 Stat. 1091 (42 U.S.C. 1594a (b)).[4] The condemnation proceedings were initiated by the filing of declarations of taking and the deposit of the estimated compensation for the properties in the appropriate district courts in Texas and California pursuant to Section 1 of the Act of February 26, 1931, c. 307, 46 Stat. 1421 (40 U.S.C. 258a). The declarations of taking recited that the properties being taken consisted of all right, title and interest of the Wherry corporations "subject to the interest of" the mortgagees. The Wherry corporations contested the proceedings only with regard to the issue of just compensation. (Pet. App. B 46–47.)

The United States then entered into agreements with the mortgagees assuming the liabilities of the Wherry corporations on their mortgages (Pet. App. B 48–49). On August 27, 1958, and September 2, 1958, the Wherry corporations requested and received the funds which had been deposited by the United States in the district courts as estimated compensation for the taking (Pet. App. B 49). On August 11, 1958, each of the Wherry corporations had adopted a plan of liquidation (Pet. App. B 49). They completed the liquidations on August 8, 1959 (Pet. App. B 97).

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[4] The Capehart Housing Act, as amended, provided for housing to be built by the federal government and the purchase of Wherry housing at military installations where Capehart housing was to be built.

The Tax Court upheld the Commissioner's determination that, in fiscal 1958 when the properties were taken, each Wherry corporation realized gain from the condemnation sale in the amount of the excess of the principal amount of the mortgage liability assumed over the cost basis (Pet. App. B 94–95). The Tax Court further held that the condemnation sales occurred when the declarations of taking were filed and title vested in the United States. Since the declarations were filed prior to the adoption of the plans of liquidation, the Tax Court concluded that the nonrecognition-of-gain provisions of Section 337 of the Internal Revenue Code of 1954 did not apply (Pet. App. B 98–99). The court of appeals held that the condemnation sales occurred and the gains thereon were realized when the United States assumed the mortgages by agreement with the mortgagees, which also preceded adoption of the liquidation plans, and accordingly affirmed the Tax Court's holding that Section 337 was inapplicable (Pet App. A 6–7, 14–17).

II

During the fiscal year ended June 30, 1957, Topeka conveyed some of the houses it had constructed to the four Wherry corporations and they, in turn, immediately resold the properties to the public. Topeka's books showed that the price paid by the Wherry corporations exceeded Topeka's basis by $882,968 (Pet. App. B 29). The books of the Wherry corporations disclosed that they resold the properties for $387,654 in excess of the amount paid by them to Topeka (Pet.

App. B 31). Since Topeka and the Wherry corporations were part of a consolidated group, Topeka reported no gain from its transactions with the Wherry corporations (Pet. App. B 30). The Wherry corporations reported their sales on an installment basis and reported a gain of $472,841 for the fiscal year ended June 30, 1957 (Pet. App. B 31).

The Wherry corporations had preconsolidation net operating loss carryovers which could only be set off against their income and not against the income of other members of the consolidated group. Treasury Regulations 1.1502–31A(b)(3)(i). Topeka had no net operating loss carryover. The transactions were arranged so that the preconsolidation net operating loss of each Wherry corporation could be set off in full against the gain from the sales of the houses (Pet. App. B 31–32).

Exercising the allocation powers delegated to him by Section 482 of the Internal Revenue Code of 1954, the Commissioner determined that the gains reported by the subsidiary Wherry corporations from sales of the houses to the public were taxable to the commonly controlled subsidiary Topeka, which had constructed the houses for sale, but which, for the purpose of reducing tax liability transferred them to the Wherry corporations for purposes of sale. The Tax Court sustained the Commissioner's determination (Pet. App. B 60–66), and the court of appeals affirmed (Pet. App. A 9–12).

ARGUMENT

The court below correctly affirmed the Tax Court's determination of the issues raised by petitioners' appeals. There is no conflict, nor any other reason for further review by this Court.

1. Section 337 of the Internal Revenue Code of 1954 lays down several conditions precedent to nonrecognition of gain realized upon a liquidation sale of corporate assets, including the requirement that the sale occur within 12 months after adoption of a plan of complete liquidation. In holding that the gains realized by the Wherry corporations from the condemnation sales of their properties were not entitled to the nonrecognition-of-gain benefits of Section 337, because the sales took place prior to adoption of the plans of liquidation, the courts below reached the only decision compatible with the language of that section and the relevant decisions.[5]

The condemnation proceedings in the instant case were conducted pursuant to Section 1 of the Act of February 26, 1931, c. 307, 46 Stat. 1421 (40 U.S.C. 258a), Appendix, *infra*, pp. 17–19. That section provides

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[5] There is no dispute as to the amount of gain in question, or as to whether the condemnation proceedings resulted in a "sale" within the meaning of Section 337. It is settled that where mortgaged property is sold and the purchaser assumes (or takes subject to) the mortgage, the amount of gain "realized" by the seller includes the excess of the mortgage principal over the seller's basis in the mortgaged property. *Crane* v. *Commissioner*, 331 U.S. 1. It is also settled that involuntary conversions such as condemnations are "sales or exchanges" within the purview of Section 337. See, *e.g.*, *Covered Wagon, Inc.* v. *Commissioner*, 369 F. 2d 629 (C.A. 8), and cases there cited.

that title vests in the United States at the time of filing the declaration of taking and the deposit of estimated compensation in the district court, and that the right to compensation vests immediately, with a right to 6 percent interest on the amount by which the final award exceeds the deposit. In this case, the United States obtained not only title but immediate possession of the properties involved. (Pet. App. B 94–95.) Since title and possession had been conveyed and the right to compensation had vested in October and November, 1957—and the liquidation plans were not adopted until August, 1958—petitioners were not entitled to the benefit of Section 337. The courts have uniformly held that, for purposes of Section 337, the "sale" in a condemnation proceeding is deemed to have taken place not later than the vesting of title in the taking authority and the simultaneous vesting of the right to compensation. See, *e.g., Covered Wagon, Inc.* v. *Commissioner,* 369 F. 2d 629 (C.A. 8), which also involved a condemnation pursuant to Section 1 of the Act of February 26, 1931, *supra; Dwight* v. *United States,* 328 F. 2d 973 (C.A. 2); *Wendell* v. *Commissioner,* 326 F. 2d 600 (C.A. 2); *Wood Harmon Corp.* v. *United States,* 206 F. Supp. 773 (S.D. N.Y.), affirmed on another issue, 311 F. 2d 918 (C.A. 2); *Towanda Textiles, Inc.* v. *United States,* 180 F. Supp. 373 (Ct. Cl.); *Travis* v. *United States,* 287 F. 2d 916 (Ct. Cl.), certiorari denied, 368 U.S. 824.[6]

[6] It is true, as petitioners point out (Pet. 9), that the time of vesting of title under state condemnation laws varies from state to state, and that Section 337, which turns on when a sale occurs, might be available in connection with some state condemnations.

Petitioners' reliance (Pet. 8) upon *United States* v. *Morton*, 387 F. 2d 441 (C.A. 8), and similar cases involving destruction of insured property, is misplaced. *Morton* was decided by the Eighth Circuit, the same court which decided *Covered Wagon, supra*; as the court below pointed out (Pet. App. A 7), *Morton* did not involve a condemnation sale, and the Eighth Circuit there expressly adhered to its decision in *Covered Wagon*, which did involve a condemnation sale, as does the instant case. Moreover, as the court below also observed (*id.*, p. 7), the *Morton* decision turned on the fact that the amount received from the insurance company as reimbursement for the fire loss there involved, was unascertainable prior to adoption of the plan of liquidation, "whereas the amount of the deposits sought to be taxed in this case as capital gain was determined either on the date of condemnation or prior to the adoption of the plans of liquidation."[7]

But the condemnation sales here involved took place pursuant to a federal statute. See *Covered Wagon, Inc.* v. *Commissioner, supra*. Moreover, where property rights are involved, it is not unusual for the incidents of federal taxation to turn on local law. *Fernandez* v. *Wiener*, 326 U.S. 340, 359–360.

[7] Even if petitioners had no opportunity to adopt a liquidation plan prior to the condemnation sale, they would not have been entitled to the benefit of Section 337. As the Second Circuit noted in *Dwight* v. *United States*, *supra*, where the taxpayer had no advance notice of the condemnation (p. 974): "Hence the corporation had no opportunity to adopt a plan of liquidation before condemnation, and the conditions of section 337 could not be met. This may appear a harsh result, but if it is to be corrected Congress must act; the courts have no power to do so." A fortiori, petitioners are not entitled to the benefit of Section 337 where, as here, the government had a duty to negotiate with

2. Petitioners' contention (Pet. 11–15) that the recognizable gains from the condemnation sales did not "accrue" (and hence were not "realized") in the year of sale, but in a later taxable year not before the Court, was not advanced in the court below.[8] Having failed to raise the issue in the court below, petitioners may not do so in the petition for certiorari. *Zellerbach Co.* v. *Helvering*, 293 U.S. 172, 182; *Lawn* v. *United States*, 355 U.S. 339, 362, n. 16; *Duignan* v. *United States*, 274 U.S. 195, 200; *Helvering* v. *Wood*, 309 U.S. 344, 349. Indeed, petitioners acknowledge (Pet. 15), as they must, that the lone case with which they allege direct conflict in this connection (*Commissioner* v. *Henry Hess Co.*, 210 F. 2d 553 (C.A. 9)) "was not called to the attention of the court below," and accordingly was not considered or even mentioned by that court. In any event, *Hess* presented a situation quite different from that here presented. The question in *Hess* was whether an accrual basis corporation was taxable on gain from the requisition of its property, notwithstanding that the gain accrued in a year after the corporation had been dissolved and ceased to exist. No such question is here presented, since the Wherry corporations were still in existence

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them prior to instituting the condemnation proceedings. See Housing Amendments of 1955, c. 783, 69 Stat. 635, Sec. 404, as amended (42 U.S.C. 1594a(c)), Appendix, *infra*, pp. 19–20.

[8] Petitioners contended below that the gains were not realized in the year title and possession passed to the United States and the mortgages were assumed, on grounds other than that now urged in the petition. These grounds were properly rejected (Pet. App. A 3–6; Pet. App. B 96–99) and are no longer urged here.

when the gains from the condemnation sales accrued. Nothing in the *Hess* opinion warrants petitioners' assumption (Pet. 13) that gain from a condemnation sale cannot accrue prior to final payment of the condemnation award.

As for the other cases with which petitioners assert conflict "in principle" (Pet. 11), they were cited by the court below (Pet. App. A 8–9) in rejecting petitioners' argument on an entirely distinct issue—not raised in their petition—namely, whether Honolulu, parent of the Wherry corporations and transferee of their assets upon their liquidation, was entitled to deduct contested tax liabilities in the year of the liquidation. The courts below correctly held that these tax liabilities did not "accrue" until the contest was terminated, and petitioners do not challenge that holding here. Insofar as accrual of gain from a condemnation sale is concerned, *Covered Wagon, supra,* is directly in point. It was there held that the gain accrues in the year when the government takes title and makes a deposit, even though final payment of the compensation is made in a later year.

3. Section 482 of the Internal Revenue Code of 1954 vests in the Commissioner broad authority to allocate gross income and deductions among commonly controlled organizations if such allocation "is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organization * * *." It is settled that Section 482 empowers the Commissioner to scrutinize closely transactions between commonly controlled corporations in order to determine whether

such transactions would have been entered into in arm's length negotiations between strangers, and to allocate income or deductions between the controlled corporations if they fail to meet that standard, and that the Commissioner's exercise of the discretion delegated to him by Congress in that section should not be disturbed unless plainly arbitrary or unreasonable. See, *e.g., Local Finance Corp.* v. *Commissioner*, 407 F. 2d 629 (C.A. 7), No. 561, this Term, certiorari denied, December 8, 1969, and cases there cited; Treasury Regulations 1.482–1(b)(1).

The courts below correctly sustained the Commissioner's determination, pursuant to Section 482, that the gains reported in the consolidated returns by the Wherry corporations from sales of houses to the public were taxable to another subsidiary of Honolulu (Topeka) which had constructed the houses for sale, but which for purposes of tax reduction (carryover of separate net operating losses not otherwise usable on the consolidated return), first purportedly "sold" the houses to the Wherry corporations for immediate resale to the public. This was done in a year when all of the corporations participated in a consolidated return. The evidence shows, as both courts below found (Pet. App. A 9–11; Pet. App. B 60–66), that the purpose of the intercompany transfers was to provide the transferees with income against which they could offset operating loss carryovers not otherwise available to the consolidated group because they were sustained in preconsolidation years in which the transferee-loss cor-

porations had filed separate returns. On the basis of that evidence, the Commissioner was fully justified in allocating the gain from the Wherry corporations to Topeka.

There is no merit in petitioners' contention (Pet. 17–18) that Section 482 does not apply to taxpayers who participate in filing a consolidated return. The longstanding Treasury Regulations under Section 482 (Section 1.482–1(b)(2), Appendix, *infra,* p. 20) specifically provide that Section 482 and the regulations under it "apply to the case of any controlled taxpayer, whether such taxpayer makes a separate or a consolidated return." This Court has "many times declared that Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons." *Commissioner* v. *South Texas Co.,* 333 U.S. 496, 501. Furthermore, the regulation in issue comes within "the settled principle that 'Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law' ". *United States* v. *Correll,* 389 U.S. 299, 305–306, quoting from *Helvering* v. *Winmill,* 305 U.S. 79, 83. See also *Lykes* v. *United States,* 343

U.S. 118, 129.[9] If any doubt otherwise existed regarding the applicability of Section 482 to taxpayers filing consolidated returns, it is dispelled by Code Section 1505, which, in enumerating cross-references relevant to the consolidated return sections, specifically refers to Section 482. See also Treasury Regulation 1.1502–80; Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders* (2d ed. 1966), p. 695.

Petitioners' alternative contentions (Pet. 18–20) that Code Sections 269 and 1551[10] are inapplicable are addressed to straw issues. The Commissioner's determination that the gains attributed to the Wherry corporations in the consolidated return were earned by and taxable to Topeka was made pursuant to the allocation powers vested in him by Section 482, not by virtue of the provisions of Section 269 or Section 1551.

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[9] Treasury Regulation 1.482–1(b)(2) originally appeared as Treasury Regulations 86, Art. 45–1(b) under the Revenue Act of 1934 which provided, as do the present Regulations, that "Section 45 [of the Revenue Act of 1934—the original predecessor of Section 482] and this article apply to the case of any controlled taxpayer, whether such taxpayer makes a separate or a consolidated return."

[10] In the court below petitioners did not rely on Section 1551, but on Section 382(b)(3).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1954:

Sec. 1505. Cross References.

(1) For suspension of running of statute of limitations when notice in respect of a deficiency is mailed to one corporation, see section 6503(a)(1).

(2) For allocation and deductions of related trades or businesses, see section 482.

[26 U.S.C. 1505.]

Act of February 26, 1931, c. 307, 46 Stat. 1421, Section 1:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That in any proceeding in any court of the United States outside of the District of Columbia which has been or may be instituted by and in the name of and under the authority of the United States for the acquisition of any land or easement or right of way in land for the public use, the petitioner may file in the cause, with the petition or at any time before judgment, a declaration of taking signed by the authority empowered by law to acquire the lands described in the petition, declaring that said lands are thereby taken for the use of the United States. Said declaration of taking shall contain or have annexed thereto—

(1) A statement of the authority under which and the public use for which said lands are taken.

(2) A description of the lands taken sufficient for the identification thereof.

(3) A statement of the estate or interest in said lands taken for said public use.

(4) A plan showing the lands taken.

(5) A statement of the sum of money estimated by said acquiring authority to be just compensation for the land taken.

Upon the filing said declaration of taking and of the deposit in the court, to the use of the persons entitled thereto, of the amount of the estimated compensation stated in said declaration, title to the said lands in fee simple absolute, or such less estate or interest therein as is specified in said declaration, shall vest in the United States of America, and said lands shall be deemed to be condemned and taken for the use of the United States, and the right to just compensation for the same shall vest in the persons entitled thereto; and said compensation shall be ascertained and awarded in said proceeding and established by judgment therein, and the said judgment shall include, as part of the just compensation awarded, interest at the rate of 6 per centum per annum on the amount finally awarded as the value of the property as of the date of taking, from said date to the date of payment; but interest shall not be allowed on so much thereof as shall have been paid into the court. No sum so paid into the court shall be charged with commissions or poundage.

Upon the application of the parties in interest, the court may order that the money deposited in the court, or any part thereof, be paid forthwith for or on account of the just compensation to be awarded in said proceeding. If the compensation finally awarded in respect of said lands, or any parcel thereof, shall exceed the amount of the money so received by any person entitled, the court shall enter judgment against the United States for the amount of the deficiency.

Upon the filing of a declaration of taking, the court shall have power to fix the time within

which and the terms upon which the parties in possession shall be required to surrender possession to the petitioner. The court shall have power to make such orders in respect of encumbrances, liens, rents, taxes, assessments, insurance, and other charges, if any, as shall be just and equitable.

* * * * *

[40 U.S.C. 258a.]

Capehart Housing Amendments of 1955, c. 783, 69 Stat. 635:

Sec. 404 [as amended by Sec. 512, Housing Act of 1956, c. 1029, 70 Stat. 1091, 1111]. * * *

* * * * *

(c) Condemnation proceedings instituted pursuant to this section shall be conducted in accordance with the provisions of the Act of August 1, 1888 (25 Stat. 357; 40 U.S.C., sec. 257) as amended, or any other applicable Federal statute. Before any such condemnation proceedings are instituted, an effort shall be made to acquire the property involved by negotiation. In any condemnation proceedings instituted pursuant to this section, the court shall not order the party in possession to surrender possession in advance of final judgment unless a declaration of taking has been filed, and a deposit of the amount estimated to be just compensation has been made, under the first section of the Act of February 26, 1931 (46 Stat. 1421), providing for such declarations. Unless title is in dispute, the court, upon application, shall promptly pay to the owner at least 75 per centum of the amount so deposited, but such payment shall be made without prejudice to any party to the proceeding. In the event that condemnation proceedings are instituted in accordance with procedures under such Act of February 26, 1931, the court shall order that the amount deposited shall be paid in a lump

sum or over a period not exceeding five years in accordance with stipulations executed by the parties in the proceedings. In connection with condemnation proceedings which do not utilize the procedures under such Act, the Secretary or his designee, after final judgment of the court, may pay or agree to pay in a lump sum or, in accordance with stipulations executed by the parties to the proceedings, over a period not exceeding five years the difference between the outstanding principal obligation, plus accrued interest, and the price for the property fixed by the court. Unless such payment is made in a lump sum, the unpaid balance thereof shall bear interest at the rate of 4 per centum per annum.

* * * * *

[42 U.S.C. 1594a.]

Treasury Regulations on Income Tax (1954 Code):

§ 1.482–1 *Allocation of income and deductions among taxpayers.*

* * * * *

(b) *Scope and purpose.* (1) * * *

(2) Section 482 and this section apply to the case of any controlled taxpayer, whether such taxpayer makes a separate or a consolidated return. If a controlled taxpayer makes a separate return, the determination is of its true separate taxable income. If a controlled taxpayer is a party to a consolidated return, the true consolidated taxable income of the affiliated group and the true separate taxable income of the controlled taxpayer are determined consistently with the principles of a consolidated return.

* * * * *

[26 C.F.R. 1.482–1.]

* * * * *

§ 1.1502–80 *Applicability of other provisions of law.*

The Code, or other law, shall be applicable to the group to the extent the regulations do not exclude its application. Thus, for example, in a transaction to which section 381(a) applies, the acquiring corporation will succeed to the tax attributes described in section 381(c). Furthermore, sections 269, 304, and 482 apply for any consolidated return year.

[26 C.F.R. 1.1502–80.]

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